MKS INSTRUMENTS INC
Form 10-Q
November 08, 2016
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

(MARK ONE)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2016

or

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from __________ to __________

Commission file number 0-23621

MKS INSTRUMENTS, INC.

(Exact name of registrant as specified in its charter)

Massachusetts	**04-2277512**
(State or other jurisdiction of	**(I.R.S. Employer**
incorporation or organization)	**Identification No.)**
2 Tech Drive, Suite 201, Andover, Massachusetts	**01810**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code (978) 645-5500

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer x	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ¨ No x

As of November 1, 2016 the registrant had 53,592,715 shares of common stock outstanding.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

MKS INSTRUMENTS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share data)

(Unaudited)

	September 30, 2016	December 31, 2015
ASSETS		
Current assets:		
Cash and cash equivalents	$ 366,874	$ 227,574
Restricted cash	5,931	
Short-term investments	53,104	430,663
Trade accounts receivable, net	243,853	101,883
Inventories, net	278,965	152,631
Other current assets	53,616	26,760
Total current assets	1,002,343	939,511
Property, plant and equipment, net	179,694	68,856
Goodwill	594,635	199,703
Intangible assets, net	419,811	44,027
Long-term investments	15,256	
Other assets	29,926	21,250
Total assets	$ 2,241,665	$ 1,273,347
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Short-term borrowings and current portion of long-term debt	$ 11,528	$
Accounts payable	68,371	23,177
Accrued compensation	63,424	28,424
Income taxes payable	13,758	4,024
Other current liabilities	73,354	35,359
Total current liabilities	230,435	90,984
Long-term debt, net	639,068	
Non-current deferred taxes	91,928	2,655
Non-current accrued compensation	44,739	13,395
Other liabilities	19,956	5,432

Total liabilities		1,026,126		112,466
Commitments and contingencies (Note 20)				
Stockholders equity:				
Preferred Stock, $0.01 par value per share, 2,000,000 shares authorized; none issued and outstanding				
Common Stock, no par value, 200,000,000 shares authorized; 53,578,091 and 53,199,720 shares issued and outstanding at September 30, 2016 and December 31, 2015, respectively		113		113
Additional paid-in capital		770,444		744,725
Retained earnings		458,369		427,214
Accumulated other comprehensive loss		(13,387)		(11,171)
Total stockholders equity		1,215,539		1,160,881
Total liabilities and stockholders equity	$	2,241,665	$	1,273,347

The accompanying notes are an integral part of the consolidated financial statements.

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MKS INSTRUMENTS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

AND COMPREHENSIVE INCOME

(in thousands, except per share data)

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Net revenues:				
Products	$ 335,156	$ 179,441	$ 774,248	$ 553,818
Services	45,504	29,891	115,954	87,319
Total net revenues	380,660	209,332	890,202	641,137
Cost of revenues:				
Cost of products	183,789	95,710	433,134	294,211
Cost of services	28,486	19,393	74,857	56,853
Total cost of revenues (exclusive of amortization shown separately below)	212,275	115,103	507,991	351,064
Gross profit	168,385	94,229	382,211	290,073
Research and development	32,268	17,217	77,709	51,464
Selling, general and administrative	70,424	33,396	175,803	97,532
Acquisition costs	233		10,932	30
Restructuring		562	24	1,569
Amortization of intangible assets	12,452	1,691	22,990	5,071
Income from operations	53,008	41,363	94,753	134,407
Interest and other (expense) income, net	(10,760)	721	(16,332)	2,015
Income before income taxes	42,248	42,084	78,421	136,422
Provision for income taxes	9,699	12,315	19,099	39,647
Net income	$ 32,549	$ 29,769	$ 59,322	$ 96,775
Other comprehensive income:				
Changes in value of financial instruments designated as cash flow hedges, net of tax (expense) benefit[(1)]	$ (229)	$ 939	$ (2,104)	$ 2
Foreign currency translation adjustments, net of tax of $0	5,698	(3,623)	(536)	(6,217)

Unrealized (loss) gain on investments and minimum pension liability adjustment, net of tax (benefit) expense[(2)]		(31)		100		424		16
Total comprehensive income	$	37,987	$	27,185	$	57,106	$	90,576
Net income per share:								
Basic	$	0.61	$	0.56	$	1.11	$	1.82
Diluted	$	0.60	$	0.56	$	1.10	$	1.81
Cash dividends per common share	$	0.17	$	0.17	$	0.51	$	0.505
Weighted average common shares outstanding:								
Basic		53,574		53,314		53,423		53,304
Diluted		54,315		53,568		53,895		53,562

(1) Tax (benefit) expense was $(117) and $548 for the three months ended September 30, 2016 and 2015, respectively. Tax (benefit) expense was $(1,357) and $20 for the nine months ended September 30, 2016 and 2015, respectively.

(2) Tax (benefit) expense was $(15) and $59 for the three months ended September 30, 2016 and 2015, respectively. Tax expense was $274 and $221 for the nine months ended September 30, 2016 and 2015, respectively.

The accompanying notes are an integral part of the consolidated financial statements.

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MKS INSTRUMENTS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(Unaudited)

	Nine Months Ended September 30, 2016	2015
Cash flows provided by operating activities:		
Net income	$ 59,322	$ 96,775
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	43,757	16,606
Amortization of inventory step-up adjustment to fair value	15,090	
Amortization of debt issuance cost and original issue discount	6,453	
Stock-based compensation	19,826	10,025
Provision for excess and obsolete inventory	11,045	9,235
Provision for bad debt	167	(358)
Deferred income taxes	(9,567)	(2,153)
Excess tax benefits from stock-based compensation	(678)	(884)
Other	125	248
Changes in operating assets and liabilities:		
Trade accounts receivable	(44,508)	(11,424)
Inventories	(5,077)	(25,219)
Income taxes	20,418	10,461
Other current assets	(8,846)	(7,935)
Accrued compensation	4,460	3,619
Other current and non-current liabilities	4,568	4,557
Accounts payable	14,110	(7,542)
Other assets	(3,288)	(441)
Net cash provided by operating activities	127,377	95,570
Cash flows used in investing activities:		
Acquisition of businesses, net of cash acquired	(939,591)	(9,910)
Purchases of investments	(116,075)	(318,340)
Maturities of investments	148,606	131,004
Sales of investments	337,592	35,720
Proceeds from sale of property, plant and equipment	40	8
Purchases of property, plant and equipment	(11,959)	(8,831)
Net cash used in investing activities	(581,387)	(170,349)
Cash flows provided by (used in) financing activities:		
Restricted cash	(6,176)	

Proceeds from short-term borrowings	15,434	2,020
Payments of short-term borrowings	(8,289)	(2,020)
Net proceeds from long-term borrowings	743,746	
Payments of long-term borrowings	(111,825)	
Repurchase of common stock	(1,545)	(8,866)
Net payments related to employee stock awards	(3,108)	(800)
Dividend payments to common stockholders	(27,249)	(26,928)
Excess tax benefits from stock-based compensation	678	884
Net cash provided by (used in) financing activities	601,666	(35,710)
Effect of exchange rate changes on cash and cash equivalents	(8,356)	199
Increase (decrease) in cash and cash equivalents	139,300	(110,290)
Cash and cash equivalents at beginning of period	227,574	305,437
Cash and cash equivalents at end of period	$ 366,874	$ 195,147

The accompanying notes are an integral part of the consolidated financial statements.

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MKS INSTRUMENTS, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(in thousands, except share and per share data)

1) Basis of Presentation

The terms MKS and the Company refer to MKS Instruments, Inc. and its subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation. The interim financial data as of September 30, 2016 and for the three and nine months ended September 30, 2016 and 2015 are unaudited; however, in the opinion of MKS, the interim data includes all adjustments, consisting of normal recurring adjustments, necessary for a fair statement of the results for the interim periods. The condensed consolidated balance sheet presented as of December 31, 2015 has been derived from the consolidated audited financial statements as of that date. The unaudited condensed consolidated financial statements presented herein have been prepared in accordance with the instructions to Form 10-Q and do not include all of the information and note disclosures required by United States generally accepted accounting principles (U.S. GAAP). The unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the MKS Annual Report on Form 10-K for the year ended December 31, 2015 filed with the Securities and Exchange Commission on February 26, 2016.

On April 29, 2016, the Company completed its acquisition of Newport Corporation which is more fully described in Note 3 below. This transaction was recorded using the purchase method of accounting; accordingly, the financial results of the acquisition are included in the accompanying unaudited condensed consolidated financial statements for the periods subsequent to the acquisition.

The preparation of these unaudited condensed consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent liabilities at the date of the unaudited condensed consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. On an on-going basis, management evaluates its estimates and judgments, including those related to revenue recognition, stock-based compensation, inventory, intangible assets, goodwill and other long-lived assets, warranty liabilities, pension liabilities, acquisition expenses, income taxes and investments. Management bases its estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

2) Recently Issued Accounting Pronouncements

In August 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-15, Statement of Cash Flows (Topic 230)-Classification of Certain Cash Receipts and Cash Payments. This standard addresses eight specific cash flow issues with the objective of addressing the diversity in practice in how certain cash receipts and cash payments are presented and classified in the statement of cash flows under Topic 230. The provisions of this ASU are effective for annual periods beginning after December 15, 2017, including interim periods within those fiscal years. The Company is currently evaluating the requirements of this ASU and has not yet determined its impact on the Company s consolidated financial statements.

In March 2016, the FASB issued ASU 2016-09, Compensation - Stock Compensation (Topic 718) Improvements to Employee Share-Based Payment Accounting. This standard simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. The provisions of this ASU are effective for annual periods beginning after December 15, 2016, including interim periods within those fiscal years and early adoption is permitted. This ASU will be adopted in the first quarter of 2017 and could have a material impact on the Company s consolidated financial statements

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). This standard requires the recognition of lease assets and liabilities for all leases, with certain exceptions, on the balance sheet. In transition, lessees and lessors are required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach. This ASU is effective for annual periods beginning after December 15, 2018, including interim periods within those fiscal years. The Company is currently evaluating the requirements of this ASU and has not yet determined its impact on the Company s consolidated financial statements.

In January 2016, the FASB issued ASU 2016-01, Financial Instruments Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. This ASU provides guidance for the recognition, measurement, presentation, and disclosure of financial instruments. The new pronouncement revises accounting related to equity investments and the presentation of certain fair value changes for financial assets and liabilities measured at fair value. Among other things, it amends the presentation and disclosure requirements of equity securities that do not result in consolidation and are not

MKS INSTRUMENTS, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(in thousands, except share and per share data)

accounted for under the equity method. Changes in the fair value of these equity securities will be recognized directly in net income. This pronouncement is effective for annual periods beginning after December 15, 2017, including interim periods within those fiscal years. The Company does not expect adoption of this ASU to have a material impact on the Company s consolidated financial statements.

In July 2015, the FASB issued ASU 2015-11, Inventory (Topic 330) Simplifying the Measurement of Inventory. The amendments in this ASU apply to all inventory that is measured using first-in, first-out or average cost. This standard requires that an entity measure inventory within the scope of this update at the lower of cost and net realizable value. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. The amendments in this ASU are effective for annual periods beginning after December 15, 2016, including interim periods within those fiscal years. The Company does not expect adoption of this ASU to have a material impact on the Company s consolidated financial statements.

In August 2014, the FASB issued ASU 2014-15, Presentation of Financial Statements Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity s Ability to Continue as a Going Concern. Under this guidance, management will be required to assess an entity s ability to continue as a going concern, and to provide related footnote disclosures in certain circumstances. The provisions of this ASU are effective for annual periods beginning after December 15, 2016, including interim periods within those fiscal years. The Company does not expect the adoption of this ASU to have an impact on the Company s consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606), which supersedes all existing revenue recognition requirements, including most industry-specific guidance. This standard requires a company to recognize revenue when it transfers goods and services to customers in an amount that reflects the consideration that the company expects to be entitled to in exchange for those goods or services. The ASU also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and assets recognized from costs incurred to obtain or fulfill a contract. This pronouncement is effective for annual periods beginning after December 15, 2017, including interim periods within those fiscal years. The two permitted transition methods under the new standard are the full retrospective method, in which case the standard would be applied to each prior reporting period presented, or the modified retrospective method, in which case the cumulative effect of applying the standard would be recognized at the date of initial application. The Company has not yet selected a transition method. The Company is currently evaluating the requirements of this ASU and has not yet determined its impact on the Company s consolidated financial statements.

3) Acquisitions

Newport Corporation

On April 29, 2016, the Company completed its acquisition of Newport Corporation (Newport) pursuant to an Agreement and Plan of Merger, dated as of February 22, 2016 (the Merger Agreement), by and among the Company, PSI Equipment, Inc., a wholly owned subsidiary of the Company (Merger Sub), and Newport (the Newport Merger).

At the effective time of the Newport Merger and pursuant to the terms and conditions of the Merger Agreement, each share of Newport s common stock that was issued and outstanding immediately prior to the effective time of the Newport Merger was converted into the right to receive $23.00 in cash, without interest and subject to deduction for any required withholding tax.

Newport s innovative solutions leverage its expertise in advanced technologies, including lasers, photonics and precision motion equipment, and optical components and sub-systems, to enhance the capabilities and productivity of its customers manufacturing, engineering and research applications. Newport is a global supplier of advanced-technology products and systems to customers in the scientific research and defense/security, microelectronics, life and health sciences and industrial manufacturing markets.

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MKS INSTRUMENTS, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(in thousands, except share and per share data)

The purchase price of Newport consisted of the following:

Cash paid for outstanding shares (1)	$ 905,254
Settlement of share-based compensation awards (2)	8,824
Cash paid for Newport debt (3)	93,200
Total purchase price	$ 1,007,278
Less: Cash and cash equivalents acquired	(61,463)
Total purchase price, net of cash and cash equivalents acquired	$ 945,815

(1) Represents cash paid of $23.00 per share for approximately 39,359,000 shares of Newport common stock, without interest and subject to a deduction for any required withholding tax.

(2) Represents the vested but not issued portion of Newport share-based compensation awards as of the acquisition date of April 29, 2016.

(3) Represents the cash paid for the outstanding balance of Newport s senior secured revolving credit agreement.

The Company funded the payment of the aggregate consideration with a combination of the Company s available cash on hand and the proceeds from the Company s senior secured term loan facility, as described in Note 11.

Under the acquisition method of accounting, the total estimated acquisition consideration is allocated to the acquired tangible and intangible assets and assumed liabilities of Newport based on their fair values as of the acquisition date. Any excess of the acquisition consideration over the fair value of assets acquired and liabilities assumed is allocated to goodwill. The Company expects that all such goodwill and intangible assets will not be deductible for tax purposes.

The following table summarizes the allocation of the preliminary purchase price to the fair values assigned to assets acquired and liabilities assumed at the date of the Newport Merger:

Current assets (including cash)	$ 185,155
Inventory	142,714
Intangible assets	399,806
Goodwill	396,216
Property, plant and equipment	119,932

Long-term assets	22,725
Total assets acquired	1,266,548
Current liabilities	98,458
Other long-term liabilities	160,812
Total liabilities assumed	259,270
Fair value of assets acquired and liabilities assumed	1,007,278
Less: Cash and cash equivalents acquired	(61,463)
Total purchase price, net of cash and cash equivalents acquired	$ 945,815

For the three and nine months ended September 30, 2016, the Company recorded $4,971 and $15,090 incremental cost of sales charges associated with the fair value write-up of inventory acquired in the merger with Newport.

The fair value write-up of acquired property, plant and equipment of $36,242 will be amortized over the useful life of the asset. Property, plant and equipment is valued at its value-in-use, unless there was a known plan to dispose of the asset.

The acquired intangible assets are being amortized on a straight-line basis, which approximates the economic use of the asset.

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MKS INSTRUMENTS, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(in thousands, except share and per share data)

The following table reflects the allocation of the acquired intangible assets and liabilities and related estimate of useful lives:

Order backlog	$ 12,100	1 year
Customer relationships	243,093	6-18 years
Trademarks and trade names	55,900	Indefinite
Developed technology	75,386	4-8 years
In-process research and development	6,899	Undefined[(1)]
Leasehold interest, net[(2)]	2,126	4-5 years
Total	$ 395,504	

(1) The useful lives of in-process research and development will be defined in the future upon further evaluation of the status of these programs.

(2) Leasehold interest is comprised of a favorable leasehold asset of $6,428 and an unfavorable leasehold liability of $4,302.

The fair value of the acquired intangibles was determined using the income approach. In performing these valuations, the key underlying probability-adjusted assumptions of the discounted cash flows were projected revenues, gross margin expectations and operating cost estimates. The valuations were based on the information that was available as of the acquisition date and the expectations and assumptions that have been deemed reasonable by the Company s management. There are inherent uncertainties and management judgment required in these determinations. This acquisition resulted in a purchase price that exceeded the estimated fair value of tangible and intangible assets, the excess amount of which was allocated to goodwill.

While the Company uses its best estimates and assumptions as part of the purchase price allocation process to value the assets acquired and liabilities assumed on the acquisition date, its estimates and assumptions are subject to refinement. Fair value estimates are based on a complex series of judgments about future events and uncertainties and rely heavily on estimates and assumptions. The judgments used to determine the estimated fair value assigned to each class of assets acquired and liabilities assumed, as well as asset lives, can materially impact the Company s results of operations. The finalization of the purchase accounting assessment will result in a change in the valuation of assets acquired and liabilities assumed and may have a material impact on the Company s results of operations and financial position. As a result, during the measurement period, which may be up to one year from the acquisition date, the Company will record adjustments to the assets acquired and liabilities assumed with a corresponding offset to goodwill to reflect additional information received about facts and circumstances which existed at the date of acquisition. The Company records adjustments to the assets acquired and liabilities assumed subsequent to the purchase price allocation period in the Company s operating results in the period in which the adjustments were determined. The size and breadth of the Newport Merger necessitates the use of this measurement period to adequately analyze and assess a number of the factors used in establishing the fair value of certain tangible and intangible assets acquired and liabilities assumed as of the acquisition date and the related tax impacts of any changes made. Any potential adjustments made could be material in relation to the preliminary values presented above.

The Company believes the amount of goodwill relative to identifiable intangible assets relates to several factors including: (1) potential buyer-specific synergies related to market opportunities for a combined product offering; and (2) potential to leverage the Company s sales force to attract new customers and revenue and cross sell to existing customers.

The results of this acquisition were included in the Company s consolidated operations beginning on April 29, 2016. Newport constitutes the Company s Light & Motion Division reportable segment (see Note 19).

Certain executives from Newport have severance provisions in their respective Newport employment agreements. The agreements include terms that are accounted for as dual-trigger arrangements. Through the Company s acquisition accounting, the expense relating to these benefits was recognized in the combined entity s financial statements, however, the benefit itself will not be distributed until the final provision is met by each eligible executive. The Company recorded costs of $6,631 and $3,334 as compensation expense and stock-based compensation expense, respectively, for the nine months ended September 30, 2016 in connection with these severance provisions. The shares underlying the restricted stock units and stock appreciation rights that are eligible for accelerated vesting if the executive exercises his rights are not issued as of each reporting period-end and are excluded from the computation of basic earnings per share and included in the computation of diluted earnings per share for such reporting period.

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MKS INSTRUMENTS, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(in thousands, except share and per share data)

Pro Forma Results

The following unaudited pro forma financial information presents the combined results of operations of the Company as if the Newport Merger had occurred on January 1, 2015. The unaudited pro forma financial information is not necessarily indicative of what the Company s condensed consolidated results of operations actually would have been had the acquisition occurred at the beginning of each year. In addition, the unaudited pro forma financial information does not attempt to project the future results of operations of the combined company.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Total net revenues	$ 380,660	$ 355,955	$ 1,070,471	$ 1,090,641
Net income	$ 35,915	$ 23,725	$ 65,313	$ 48,239
Net income per share:				
Basic	$ 0.67	$ 0.45	$ 1.22	$ 0.90
Diluted	$ 0.66	$ 0.44	$ 1.21	$ 0.90

The unaudited pro forma financial information above gives effect primarily to the following:

(1) Incremental amortization and depreciation expense related to the estimated fair value of identifiable intangible assets and property, plant and equipment from the purchase price allocation.

(2) Revenue adjustments as a result of the reduction in deferred revenue related to its estimated fair value.

(3) Incremental interest expense related to the Company s term loan credit agreement.

(4) The exclusion of acquisition costs and inventory step-up amortization from the three and nine month periods ended September 30, 2016 and the addition of these items to the nine month period ended September 30, 2015.

(5) The estimated tax impact of the above adjustments.

Investment in Reno Sub-Systems, Inc.

On April 27, 2016, the Company invested $9,300 for a minority interest in Reno Sub-Systems, Inc., a Delaware corporation, which operates in the field of semiconductor process equipment instrumentation. The Company accounted for this investment using the cost method of accounting.

Precisive, LLC

On March 17, 2015, the Company acquired Precisive, LLC (Precisive) for $12,085, net of cash acquired of $435. The purchase price included a deferred payment amount of $2,600 to cover any potential indemnification claims, which amount was paid to the sellers in the second quarter of 2016. Precisive is an innovative developer of optical analyzers based on Tunable Filter Spectroscopy, which provide real-time gas analysis in the natural gas and hydrocarbon processing industries, including refineries, hydrocarbon processing plants, gas-to-power machines, biogas processes and fuel gas transportation and metering, while delivering customers a lower total cost of ownership.

The following table summarizes the estimated fair value of the assets acquired and liabilities assumed at the date of the Precisive acquisition:

Current assets	$ 693
Non-current assets	18
Intangible assets	5,110
Goodwill	7,042
Total assets acquired	12,863
Total current liabilities assumed	(343)
Fair value of assets acquired and liabilities assumed	12,520
Less: cash acquired	(435)
Total purchase price, net of cash acquired	$ 12,085

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MKS INSTRUMENTS, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(in thousands, except share and per share data)

Substantially all of the purchase price is deductible for tax purposes. The following table reflects the allocation of the acquired intangible assets and related estimates of useful lives. These acquired intangibles will be amortized on a straight-line basis, which approximates the pattern of use.

Order backlog	$ 50	18 months
Customer relationships	1,430	8 years
Exclusive patent license	2,600	10 years
Trade names	210	10 years
Developed technology	820	10 years
Total	$ 5,110	

The fair value of the acquired intangibles was determined using the income approach. The Precisive acquisition resulted in a purchase price that exceeded the estimated fair value of tangible and intangible assets, the excess amount of which was allocated to goodwill. The Company believes the amount of goodwill relative to identifiable intangible assets relates to several factors including: (1) potential buyer-specific synergies related to market opportunities for a combined product offering; (2) potential to leverage the Company s sales force and intellectual property to attract new customers and revenue; and (3) potential to strengthen and expand into new but complementary markets, including targeting new applications such as natural gas processing, hydrocarbon processing and other oil and gas segments.

The results of this acquisition were included in the Company s consolidated operations beginning on March 17, 2015. Precisive is included in the Company s Instruments, Control and Vacuum Products group within the Vacuum & Analysis Division segment.

4) Investments

Investments classified as short-term consists of the following:

	September 30, 2016	December 31, 2015
Available-for-sale investments:		
Time deposits and certificates of deposit	$ 1,395	$ 11,892
Bankers acceptance drafts	2,487	728
Asset-backed securities	18,326	124,997
Commercial paper	2,793	
Corporate obligations	16,701	165,109

Municipal bonds	593	8,355
U.S. treasury obligations	1,152	
U.S. agency obligations	9,657	119,582
	$ 53,104	$ 430,663

Investments classified as long-term consists of the following:

	September 30, 2016	December 31, 2015
Available-for-sale investments:		
Group insurance contracts	$ 5,956	$
Cost method investments:		
Minority interest in Reno Sub-Systems, Inc.	9,300	
	$ 15,256	$

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MKS INSTRUMENTS, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(in thousands, except share and per share data)

The following tables show the gross unrealized gains and (losses) aggregated by investment category for short-term and long-term available-for-sale investments:

As of September 30, 2016:	Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Estimated Fair Value
Short-term investments:				
Available-for-sale investments:				
Time deposits and certificates of deposit	$ 1,395	$	$	$ 1,395
Bankers acceptance drafts	2,487			2,487
Asset-backed securities	18,317	13	(4)	18,326
Commercial paper	2,794		(1)	2,793
Corporate obligations	16,699	15	(13)	16,701
Municipal bonds	592	1		593
U.S. treasury obligations	1,151	1		1,152
U.S. agency obligations	9,653	4		9,657
	$ 53,088	$ 34	$ (18)	$ 53,104

As of September 30, 2016:	Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Estimated Fair Value
Long-term investments:				
Available-for-sale investments:				
Group insurance contracts	$ 5,988	$	$ (32)	$ 5,956

As of December 31, 2015:	Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Estimated Fair Value
Short-term investments:				
Available-for-sale investments:				

Time deposits and certificates of deposit	$ 11,893	$	$ (1)	$ 11,892
Bankers acceptance drafts	728			728
Asset-backed securities	125,271		(274)	124,997
Corporate obligations	165,445	5	(341)	165,109
Municipal bonds	8,346	13	(4)	8,355
U.S. agency obligations	119,699	3	(120)	119,582
	$ 431,382	$ 21	$ (740)	$ 430,663

The tables above, which show the gross unrealized gains and (losses) aggregated by investment category for available-for-sale investments as of September 30, 2016 and December 31, 2015, reflect the inclusion within short-term investments of investments with contractual maturities greater than one year from the date of purchase. Management has the ability, if necessary, to liquidate any of its investments in order to meet the Company s liquidity needs in the next 12 months. Accordingly, those investments with contractual maturities greater than one year from the date of purchase are classified as short-term investments on the accompanying balance sheet.

Interest income is accrued as earned. Dividend income is recognized as income on the date the stock trades ex-dividend. The cost of marketable securities sold is determined by the specific identification method. Realized gains or losses are reflected in income and were not material for the three and nine months ended September 30, 2016 and 2015.

5) Fair Value Measurements

In accordance with the provisions of fair value accounting, a fair value measurement assumes that the transaction to sell an asset or transfer a liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability and defines fair value based upon an exit price model.

MKS INSTRUMENTS, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(in thousands, except share and per share data)

The fair value measurement guidance establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The guidance describes three levels of inputs that may be used to measure fair value:

Level 1	Quoted prices in active markets for identical assets or liabilities assessed as of the reporting date. Active markets are those in which transactions for the asset or liability occur in sufficient frequency and volume to provide pricing information on an ongoing basis.
Level 2	Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets and liabilities include debt securities with quoted prices that are traded less frequently than exchange-traded instruments or securities or derivative contracts that are valued using a pricing model with inputs that are observable in the market or can be derived principally from or corroborated by observable market data.
Level 3	Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the Company categorizes such assets and liabilities based on the lowest level input that is significant to the fair value measurement in its entirety. The Company s assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset or liability.

Assets and liabilities of the Company are measured at fair value on a recurring basis as of September 30, 2016 and are summarized as follows:

		Fair Value Measurements at Reporting Date Using	
Description	September 30, 2016	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)